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FINANCIAL LEGISLATION EMERGES

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A House-Senate conference committee recently concluded intense negotiations over a comprehensive banking bill that includes an $8.5 billion recapitalization plan for the Federal Savings and Loan Insurance Corporation (FSLIC), limits on nonbank banks, and a moratorium on new powers for commercial banks. In addition, key provisions of the bill would also prevent FSLIC-insured institutions from leaving the insurance fund for one year, require the Federal Home Loan Bank Board to design a regulatory forbearance program for thrifts operating in economically depressed areas, provide faster check clearance by banks, give federal regulators broader authority to deal with failed and failing institutions, and extend the emergency acquisition authority under the 1982 Garn-St. Germain Act.

The Nonbank Bank Loophole

Title I of the bill would close the nonbank loophole by redefining a bank as any institution covered by the Federal Deposit Insurance Corporation (FDIC), or that makes commercial loans and offers transactions accounts. Nonbank banks are institutions that either take deposits or make commercial loans, but not both activities, and thus are not considered banks as defined by federal law. All nonbank banks established by March 5, 1987 would be allowed to continue operating, but with restrictions. This applies to nearly 168 nonbank banks. Those nonbanks would be subject to a 7 percent annual limit on asset growth, beginning one year after the date of the bill's enactment. Nonbank banks would also be restricted in their ability to cross-market products and services with their parent company unless they were being marketed jointly as of March 5, 1987. And, these nonbanks cannot establish any new locations nor may they commence any new activities.

In addition, nonbank banks would be barred from running daylight overdrafts, that is, overdrawing their accounts at their Federal Reserve Bank, a common industry practice. An exemption was granted for nonbank banks that are also primary dealers. Other restrictions included prohibiting nonbank banks from acquiring more than 5 percent of another bank or thrift, and

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allowing nonbank bank owners to convert the institution into a credit card bank only during the first 180 days following the bill's enactment.

This title of the bill also tackles the issue of nonthrift thrifts by imposing a qualified-thrift lender test on unitary savings and loan holding companies. Under the Savings and Loan Holding Company Act, unitary thrifts are permitted broad powers to engage in nonbanking activities. The qualified-thrift lender test would require such thrifts to devote at least 60 percent of their tangible assets to residential real estate if they wish to retain those powers. Purchasers of failed thrifts have up to ten years to comply with the qualified-thrift lender test.

Bank Powers Limitations

Title II of the bill imposes a strict moratorium from March 5, 1987 until March 1, 1988 on the authority of federal banking agencies to grant new securities, insurance and real estate powers for banks. The moratorium would apply to certain foreign banks and bank holding companies as well. The conference committee also agreed to one permanent curb on new bank powers. This restriction would extend to state-chartered banks that are not members of the Federal Reserve System those provisions of the Glass-Steagall Act that prohibit affiliations with firms "engaged principally" in underwriting on certain kinds of securities. Currently, states have the authority to grant a broad range of securities activities; this amendment was aimed in particular at New York regulators, where broad powers for state-chartered nonmember banks have been proposed.

The conferees strengthened the moratorium by prohibiting federal banking agencies from allowing "by action, inaction, or otherwise," any securities activities not legally authorized in writing prior to March 5, 1987. However, sales or transactions closed as of June 30, 1987 would be exempt from the limitation. This measure was directed primarily at the Office of the Comptroller, which frequently permits new activities simply by taking no action to prohibit them. In addition, banks were also prohibited from operating a "nondealer marketplace in options," a measure aimed directly at Security Pacific Corporation, which is awaiting permission from the Federal Reserve Board to provide brokerage and clearing services for options on Treasury obligations.

Rescuing the FSLIC

After more than a year of uncertainty, the House-Senate conferees agreed to an $8.5 billion (with no more than $3.75 billion to be borrowed in any one year) recapitalization plan for the troubled FSLIC. In approving this borrowing authority, rather than the $7.5 billion proposed by the Senate or the $5 billion passed by the House, the conferees were setting aside more than $800 million to replenish the secondary reserve used up by the Federal Home Loan Bank Board (FHLBB). The reserve was confiscated by the FHLBB after the FSLIC was declared insolvent. That action raised the prospect that thrifts would have to begin writing off the secondary reserve. Thrifts, however, will recover their contribution to it through a credit against the premiums they pay the FSLIC.

The bill also provides forbearance for thrifts with at least 0.5 percent regulatory capital if the institution is a victim of external economic conditions, not of mismanagement. The forbearance package would allow the thrifts to appeal certain examiner decisions affecting their asset values and capital requirements. The bill also requires the FHLBB to establish an appraisal review process to guard against overly conservative or optimistic evaluations, a new system for classifying assets consistent with the practices of commercial bank regulators, and new appraisal standards also consistent with commercial banking practices.

In addition, the bill would prohibit healthy thrifts from leaving the FSLIC for one year, after which they could apply for insurance from the FDIC and pay a penalty for leaving the fund. Because of the problems associated with the FSLIC, many thrifts have already applied for bank charters. The penalty, or exit fee, would be equal to twice the sum of special and regular assessments levied by their regulator. The bill also would direct thrift regulators to require use of generally accepted accounting principles and requires an annual audit of the Federal Asset Disposition Corporation, which was set up to warehouse and dispose of assets acquired in thrift foreclosures.

Deposit Availability

The bill's Title VI instructs the Federal Reserve Board to develop guidelines within three years that would require banks, thrifts and credit unions to make funds from "local checks" available to customers after one intervening business day. A local check is being defined as an item within the boundaries of a Fed check-processing district, not just the same city. For nonlocal checks, the Fed could permit holding the funds up to four intervening business days. Rural institutions are to be given additional leeway because their checks often take longer to clear than those of other banks.

The bill also establishes an interim schedule that will take effect one year after the bill becomes law. This would limit check holds to a maximum of two intervening business days on local checks and six days for other items. In addition, institutions would be subject to disclosure requirements. They would also be required to begin computing interest for checks deposited in interest-bearing accounts as soon as they receive "provisional credit."

There is also a provision in the bill requiring that deposit-taking institutions compute interest based on full account balances. Many institutions have paid interest based on investable balances--what is left over after reserve requirements and insurance premiums are paid--without notifying depositors.

Regulatory Provisions

The conferees' bill also contains provisions to give regulators authority to arrange interstate mergers of failing banks with assets of at least $500 million. In effect, this provision extends Title I and II of the Garn-St. Germain Depository Institutions Act which had expired last fall after

several temporary extensions. The measure also permits regulators to establish "bridge banks" so that the FDIC can operate a failed bank until a buyer is found.

In addition, the bill exempts federal regulators from across-the-board budget cuts built into the Gramm-Rudman-Hollings budget-balancing law, a move that will push the agencies to add more examiners to their staff. The conferees also freed regulators from the federal requirements that they need not exceed their budgets.

Another provision in the bill requires the General Accounting Office to consider whether banks should be forced to cash government checks without charge, regardless of whether the person cashing the check is a bank customer. And, the GAO must conduct a study to determine whether the Fed should pay fees to banks when presenting checks to be cleared.

The bill also contains provisions permitting qualified farm banks to amortize losses from agricultural loans over seven years. A qualified agricultural bank is defined as one that has less than $100 million in assets and has 25 percent of its total loans in agricultural ventures.

Conclusion

Though approved by the conferees relatively swiftly, the bill still faces several obstacles. Because the FSLIC funding provisions in the bill go beyond what either the House or Senate banking committees had approved, the bill must now be cleared by the House Rules Committee prior to final House and Senate action on the measure. Previously, the Rules Committee was instrumental in killing a bill to close the nonbank bank loophole during the second half of the 99th Congress.

The following associations essentially support the conferees' bill: the Independent Bankers Association, the U.S. League of Savings Institutions, the National Council of Savings Institutions, the Securities Industry Association, and the National Federation of Independent Business. The American Bankers Association supported closing the nonbank bank loophole without weakening the growth limitations on grandfathered companies.

Included among the opponents of the bill are the Association of Bank Holding Companies, the American Financial Services Association, the Consumer Bankers Association, and the American Retail Federation.

The Administration seems poised to veto the bill, arguing that it does not raise enough funds for the ailing FSLIC, and that its nonbank bank provisions and new bank powers moratorium are anticompetitive. The Treasury Department also continues to favor faster deregulation of the financial marketplace and is pushing the President to veto the bill. However, the Federal Reserve Board's outgoing Chairman Paul Volcker wants to move with greater caution to insure safety and soundness of the banking system. Mr. Volcker continues to oppose nonbank banks because of the potential conflicts of interest between the institution and its owner and the threat that the institutions might pose to the interbank payments system.

Deep divisions within the financial services industry have made Congress' job all but impossible, but Chairman Proxmire expects Congress to vote on the legislation by this fall. Although three titles of the bill received the most attention--the nonbank bank curbs, the new powers moratorium, and the FSLIC recapitalization--the package is considered by many to be the most ambitious banking legislation to clear a conference committee since the Depository Institutions Deregulation and Monetary Control Act of 1980.